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JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

NO. 3A January 22, 1988

JAPANESE BANKS IN THE UNITED STATES

Summary

One of the signs of the deepening economic relationship between the United States and Japan is the increased presence of Japanese banks here. While still mostly concentrated in New York and California, many are increasing their activities in other parts of the country, reflecting the continued high volume of bilateral trade and the increasing number of transplanted Japanese companies in the United States.

While some see this incursion as yet another example of Japanese firms taking on and defeating their U.S. rivals, forfeiting American jobs in the process, the reality is quite different. The added number of Japanese-owned banking concerns does not necessarily imply competititive success since they may be serving different clients. Even if these entities win business away from U.S. banks, banking employment in this country will remain about the same, as Japanese banks hire more Americans to handle the new customers, although, of course, the profits would go to Japan.

Freer competition among financial institutions in both countries is another factor likely to increase the Japanese presence here, but it is also expected to make Japanese and American financial institutions more similar.

Growth of Japanese Banks in the United States

The data in Table 1 show the recent growth of Japanese bank branches overseas. About one-third of these are in the United States; Europe and Asia each have a 30 percent share and the rest of the world accounts for the

remainder. Table 2 shows that foreign-owned banks have dramatically increased their presence in the United States in recent years, although Japanese banks have become less dominant within that group.

Table 1: Growth of Overseas Branches of Japanese Banks

	Number of Banks	Number of Offices	Assets (in billions of dollars)
December 1983	24	168	$81,068
December 1984	24	177	105,802
December 1985	25	189	120,179
December 1986	27	204	132,559
June 1987	29	216	130,481

Source: Bank of Japan, Economic Statistics Monthly

Table 2: Growth of Foreign Banks in the United States

(number of agencies, branches and subsidiaries)

	Japanese Banks	All Foreign Banks	Japan's Share
November 1972	28	101	27.8%
May 1978	59	269	21.9
December 1979	63	345	18.3
June 1981	69	384	18.0
May 1982	71	466	15.2
June 1983	75	537	14.0
June 1984	75	562	13.3
March 1986	84	623	13.5
June 1987	98	658	14.9

Source: Federal Reserve Board

Most Japanese banks begin their operations in Manhattan. The city's financial prominence is a lure for foreign banks and many of the smaller Japanese banks operate their only American office in that city. According to data from The Banker of March 1987, about 57 percent of the approximately 7,600 U.S. employees of Japan's bank branches, agencies and representative offices work in New York City.

The other large concentration of Japanese banks is in California. Twenty-three Japanese institutions have a banking presence there and five of the eleven largest banks in the state are Japanese. Californians, if not Americans generally, are not surprised to see Japanese banks in shopping centers

The JEI REPORT (ISSN 0744-6489) is published weekly except for the New Year, Memorial Day, Labor Day, Thanksgiving and Christmas holiday weeks for $40 per year by the Japan Economic Institute of America, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036. Second class postage paid at Washington, D.C. POSTMASTERS: Send address changes to JEI REPORT, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036.

and other areas of retail activity. The largest Japanese-owned bank in the state, California First, ranks as the 77th largest in the United States, with $5.7 billion in assets.

In one of the most dramatic expansions, Sanwa Bank, Ltd., one of the world's largest banks, acquired the California subsidiary of Lloyds Bank PLC in 1986. The purchase more than doubled the assets of its renamed subsidiary, Sanwa Bank California, which had been operating as Golden State Sanwa Bank. Assets increased to $3.5 billion, earning Sanwa the ranking as the ninth-largest bank in the state. In 1991 nationwide banking comes to California and the Japanese banks operating there are likely to face substantially increased competition from domestic banks, driving profits down and raising the price of acquisitions.

Acquisitions have been an important means of expansion for Japanese banks, especially in California (see JEI Report No. 42A, November 2, 1984). The International Banking Act of 1978 and other regulatory changes have made it relatively easy for U.S. banks to compete with foreigners to buy domestic institutions, but with the yen at an all-time high, U.S. banks may still look cheap to the Japanese.

Outside of New York and California, Japanese banks are scarce. Only the District of Columbia and 11 other states have any Japanese bank presence at all: Hawaii, Washington, Oregon, Illinois, Texas, Massachusetts, Florida, Michigan, Kentucky and Georgia. Japanese banks have few retail banking offices even in those states. The fourth-largest state, Pennsylvania, has no Japanese banks even though it has two of the country's biggest cities, Pittsburgh and Philadelphia. Nor are there any in Cleveland, Cincinnati, Columbus or elsewhere in Ohio.

Organizational Forms for Foreign Banks

Setting up a bank is not like most businesses: the approval of federal, and perhaps state, banking authorities is required. Depending on the kind of business the bank plans, it may choose an organizational structure from the following categories.

If it primarily intends to collect information for its parent firm's domestic clients, or solicit business for offices elsewhere in the United States, it will opt for a representative office. These operations cannot make loans or take deposits but can give referrals. Usually representative offices are small with only a few employees. Some of the regional Japanese banks confine themselves to a representative office in New York.

If business proves brisk, the bank may expand its operations and open a branch or agency. These are much larger and may have several hundred employees in one location. Legally and administratively, branches and agencies belong more to the Japanese banking system than to this country's, although they are, of course, subject to U.S. law. Agencies cannot accept deposits or perform trust functions.

Should the Japanese banking company find that its American business expands, it may opt to open a subsidiary where the regulatory burden shifts perceptibly from Japan to the United States. Foreign banks combine subsidiaries,

branches, agencies and representative offices to provide a wider range of banking services than they could otherwise. A subsidiary, for example, might involve an agency in a deal with a customer if the client could benefit from the involvement of the parent bank's worldwide network. It is no surprise then that Mitsui Manufacturers Bank, a subsidiary of Mitsui Bank, Ltd., has an office in the same Los Angeles building as the Mitsui Bank agency. California First Bank, a subsidiary of the Bank of Tokyo, Ltd., even has a representative office in Tokyo partly to facilitate coordination with its parent.

Foreign banks operating here face the same regulations as American banks and can engage in the same businesses. This principle dates from the International Banking Act of 1978. Prior to that, foreign banks could engage in activities denied U.S. banks, including doing banking in more than one state. Since 1978 they have had to declare a home state in which they operate, although many foreign banks operate under grandfather clauses that permit them to continue interstate activities begun before 1978. Even without the International Banking Act the advantage of interstate operation would have diminished as domestic banks were granted increased interstate banking privileges.

Of the 27 Japanese institutions doing banking in the United States in early 1987, 17 chose California and 10 opted for New York as home states. Since many chose state, rather than federal charters, California and New York state banking officials have important roles in supervising and regulating them. California is popular partly because so much U.S.-Japanese trade flows through that state. Since subsidiaries are governed by U.S. law, they are able to do some things that would be illegal in Japan, although the Ministry of Finance has considerable leverage it can apply informally against Japanese banks.

Table 3 lists the Japanese banks doing business in the United States and how they are organized. Some Japanese banks that are not listed have representative offices here. For purposes of comparison, the largest U.S. banking organization, Citicorp, had worldwide assets of $196 billion at the end of 1986. The Japanese bank with the largest presence here, Mitsubishi Bank, had $246 billion in worldwide assets on March 31, 1987.

Why Do Japanese Banks Come Here

Japanese banks have been moving abroad for years to be close to major financial markets, but this shift picked up speed in the mid-1980s. Since New York and London have been vital global financial markets for some time, why the heightened interest?

One reason is Japan's capital market liberalization. Investment funds, once restricted, are now generally free to move into or out of Japan. Foreign firms, which were previously restricted from raising money in Japan, can increasingly do so directly or indirectly. Japanese interest rates, once set administratively, are more and more the result of market forces. These forces have served to link Japanese and overseas capital markets. A large Japanese borrower will not use his bank in Japan, despite generally higher interest rates abroad, if he gets a more attractive offer in New York or London. Even the local banks have to know what's going on in New York in order to be competitive. While they may have a relationship with one of the big nationwide commercial banks that plays in the New York money markets, that same bank may be a rival in the race for customers.

Table 3: Japanese Banks in the United States

(assets in thousands of dollars as of June 30, 1987)

	Agencies	Branches	Subsidiaries	Other	Total
Mitsubishi Bank, Ltd.	$4,173,424	$19,035,015	$5,251,424	$147,044	$28,606,907
Dai-Ichi Kangyo Bank, Ltd.	4,761,698	21,356,788	229,638	--	26,348,124
Fuji Bank, Ltd.	4,924,974	16,342,575	3,955,815	9,182	25,232,546
Bank of Tokyo, Ltd.	1,371,778	12,660,213	10,258,572	24,533	24,315,096
Industrial Bank of Japan, Ltd.	3,396,308	8,647,968	6,588,810	65,256	18,698,342
Sanwa Bank, Ltd.	2,241,890	9,843,632	5,067,044	--	17,152,566
Sumitomo Bank, Ltd.	1,869,193	11,754,088	2,665,621	--	16,288,902
Tokai Bank, Ltd.	2,448,653	7,953,960	1,470,711	--	11,873,324
Mitsui Bank, Ltd.	1,417,264	6,709,570	1,817,647	--	9,944,481
Sumitomo Trust & Banking Co., Ltd.	1,710,254	6,973,306	--	--	8,683,560
Mitsui Trust & Banking Co., Ltd.	2,256,738	5,424,728	--	--	7,681,466
Taiyo Kobe Bank, Ltd.	1,192,001	6,072,204	--	--	7,264,205
Yasuda Trust & Banking Co., Ltd.	2,333,846	4,898,359	--	--	7,232,205
Mitsubishi Trust & Banking Corp.	2,484,043	4,518,287	144,373	--	7,146,703
Daiwa Bank, Ltd.	1,048,393	4,781,164	1,242,555	--	7,072,112
Long-Term Credit Bank of Japan, Ltd.	1,372,897	4,208,000	459,573	--	6,040,470
Norinchukin Bank, Ltd.	--	6,032,181	--	--	6,032,181
Kyowa Bank, Ltd.	1,503,843	3,462,174	93,099	--	5,059,116
Toyo Trust & Banking Co., Ltd.	1,460,566	3,393,234	--	--	4,853,800
Nippon Credit Bank, Ltd.	983,135	3,839,029	--	--	4,822,164
Bank of Yokohama, Ltd.	747,398	3,450,391	--	--	4,197,789
Hokkaido Takushoku Bank, Ltd.	666,748	2,873,844	--	--	3,540,592
Saitama Bank, Ltd.	--	3,112,004	--	--	3,112,004
Chuo Trust & Banking Co., Ltd.	--	2,471,689	--	--	2,471,689
Chiba Bank, Ltd.	--	2,279,274	--	--	2,279,274
Hokuriku Bank, Ltd.	--	1,295,241	--	--	1,295,241
Shizuoka Bank, Ltd.	--	1,144,250	--	--	1,144,250
Hyakujushi Bank, Ltd.	--	1,039,324	--	--	1,039,324
Shoko Chukin Bank, Ltd.	--	663,443	--	--	663,443
Hachijuni Bank, Ltd.	--	147,204	--	--	147,204
Total	44,365,044	186,383,139	39,244,882	246,015	270,239,080

Source: Federal Reserve Board, unpublished data.

Another reason is growth, both in the economy generally and in Japan's balance of payments. Japanese economic growth over the past 30 years has created financial assets and liabilities to match. It is inevitable that Japanese investors and borrowers would like to diversify. As the largest and best-developed financial system in the world, the United States cannot be ignored.

This rapidly increasing investor interest is reflected in Japan's balance of payments. While a current account surplus is usually interpreted to mean an excess of exports over imports, it is equally a deficiency of inbound compared to outbound investment. In fact the current account surplus is, in part, a reflection of the desire to invest abroad. Much of that investment has gone to the United States, as Table 4 shows.

Table 4: Japan's Long-Term Capital Flows, 1986

(in billions of dollars)

	World	United States
Net direct investment	$14.3	$7.8
Net securities investment	101.4	55.9
Net other long-term capital flow	15.8	1.9
Total	131.5	65.6

Source: Bank of Japan, Balance of Payments Monthly

Japanese banks are part of the process, making loans across national boundaries that are reflected in outbound capital flows and that may require a presence in the United States to solicit business and to arrange and monitor the loan. Japanese banks' interest in buying firms that are primary dealers in government securities, a controversial subject in Washington, reflects their customers' interest in those instruments. Foreign securities holdings of all Japanese banks in banking accounts and trust accounts have grown rapidly and are an increasing percentage of bank assets, reflecting the growth in the Japanese economy and moves toward international diversification.

The boom in investment in the United States reflects growing international activity. In 1985 Japanese banks passed U.S. banks for the first time in international lending and in 1986 their lead became commanding, as Table 5 shows. The position of Japanese banks was helped by an appreciating yen, where yen-based assets corresponded to a larger number of dollars.

As their activities grow, Japanese banks are expanding beyond New York and California. Mitsui Bank, for example, operates offices in New York, Los Angeles, Seattle, Chicago, Detroit, Houston, San Francisco, Atlanta and Lexington, Kentucky. While the rest of these cities are either big or on the West Coast, Lexington would appear to be a puzzle. It isn't. Lexington is a few miles from Georgetown, Kentucky, site of Toyota Motor Corp.'s almost completed car assembly plant. Moreover, many of Toyota's suppliers are building plants in the same general area.

Table 5: International Banking Assets

(in billions of dollars)

	December 1985	December 1986
Japan	$706.7	$1,117.7
United States	589.5	598.3
France	233.7	276.1
United Kingdom	192.2	211.7
West Germany	191.2	270.0

Source: Bank for International Settlements

Mitsui Bank has a close association with Toyota. While the Mitsui representative office in Lexington cannot do banking business, it can play an important role in lining up financing, making wire transfers, and negotiating local banking arrangements. In fact, Mitsui is one of four Japanese banks in Lexington, along with Sanwa Bank, Tokai Bank, Ltd. and the Bank of Tokyo Trust Co., the New York subsidiary of the Bank of Tokyo.

This example illustrates another powerful motive for Japanese banks to move to the United States: the presence of their Japanese customers. Traditionally, that has meant exporters. Arranging trade financing has been an important business. For instance, Mitsui Manufacturers Bank, a Mitsui Bank subsidiary, is one of the largest issuers of trade letters of credit in California despite its relatively small size. In some cases U.S. offices primarily serve those exporting to Japan. When the Japanese bought less in this country with the dollar high relative to the yen in early 1985, Japanese banks in Seattle that were heavily involved in exporting logs and lumber and grain found themselves with much less to do.

More recently, with the surge of direct investment in the United States, banks have followed their Japanese customers to the location of foreign investment. As the Toyota example suggests, this implies increased geographical dispersion throughout the United States. California, with its 1,000-plus subsidiaries of Japanese companies, is likely to continue to be particularly important, however.

As Toyota brought its suppliers, these smaller companies can also be expected to bring their own regional banks with them. The recent flurry of activity by regional banks establishing New York representative offices may represent not only a perception that capital markets are becoming international but the first step toward establishing more extensive U.S. operations outside New York.

A further reason Japanese banks come here is because the banking structure offers them new opportunties. For example, nationwide commercial banks (city banks) cannot engage in trust banking in Japan, but are free to offer these services in the United States. Most have established subsidiaries to do just that, serving the U.S. subsidiaries of Japanese firms and gaining valuable experience in the trust business. The experience should prove useful when, as is likely, the business is opened to them in Japan. More generally, the banks

profit from the experience in a comparatively deregulated banking market, which could prove vital as the home market is liberalized.

Finally, Japanese banks become part of the U.S. banking system and are entitled to the benefits it provides. By setting up operations here, Japanese banks have access to the Federal Reserve Board's discount window. As with other kinds of direct foreign investment, their presence is insurance against possible future restrictions imposed by Tokyo, Washington, or even London. Japanese banks can and do join all sorts of electronic domestic payment and information networks, including Fedwire, an important means of transferring domestic funds operated by the Federal Reserve.

What Do Japanese Banks Do Here?

When a Californian sees a sign for Sumitomo Bank of California he might wonder whether that bank wants to, and is legally able to, provide him with banking services. Are Japanese banks here to serve Japanese companies and individuals or are they available to American retail customers as well?

As already suggested the answer depends partly on the bank's form of organization. Agencies and branches are restricted in the banking services they can provide and representative offices cannot offer any banking services, but serve a variety of other functions. Sometimes, as in Lexington, they are located near their customers. Often they are listening posts for political and economic developments. Subsidiaries are another matter. Some are engaged in extensive retail banking, but often foreign banks, including Japanese, are less interested in serving relatively small depositors and borrowers than medium-size and large corporations. Some Japanese subsidiaries in California reflect an earlier period when foreign banks, restricted in setting up branches there, established subsidiaries to conduct international banking.

Subsidiaries are perhaps the most diverse in terms of their activities. Some serve mainly Japanese clients; others, Americans. Table 6 lists the subsidiaries of Japanese banks in the United States in order of assets. In a report on this subject in the early 1980s, Dai-Ichi Kangyo Bank of California said its clients were 60 percent American and 40 percent Japanese. Ninety percent of Tokai Bank of California's customers were non-Japanese. In general, bank officials estimated that about 10 percent of all their business involved Japanese clients. Some acquired subsidiaries continue their traditional business. Manufacturers Bank in Los Angeles, acquired by Mitsui Bank in 1981, has continued to be a specialist at lending to medium-size firms.

Generally, foreign banks specialize in wholesale banking in the United States. While most of their activity is still lending, esecially to large corporations and to government, in recent years they have begun moving into other activities. One such area is the arcane world of standby letters of credit, where Japanese banks are prominent. Today many U.S. companies and local governments have found that they can save money by issuing securities directly to the public, rather than borrowing money from a bank or other financial institution. The buyers of these securities typically want some assurance that the issuer will not default. One way to provide this assurance is with a standby letter of credit, a promise to pay the holder of the security in the event the issuer defaults. In return for the risk the bank collects a fee. Of course, few security holders would value this standby letter of credit very highly if

Table 6: Subsidiaries of Japanese Banks in the United States

(assets in thousands of dollars as of June 30, 1987)

Subsidiary	Parent	State	Assets
California First Bank	Bank of Tokyo, Ltd.	California	$5,699,514
Sanwa Bank California	Sanwa Bank, Ltd.	California	5,067,044
Bank of Tokyo Trust Co.	Bank of Tokyo, Ltd.	New York	4,559,058
Industrial Bank of Japan Trust Co.	Industrial Bank of Japan, Ltd.	New York	3,995,714
Fuji Bank & Trust Co.	Fuji Bank, Ltd.	New York	3,955,815
Bank of California	Mitsubishi Bank, Ltd.	California	3,760,907
Sumitomo Bank of California	Sumitomo Bank, Ltd.	California	2,665,621
IBJ Schroder Bank & Trust Co.	Industrial Bank of Japan, Ltd.	New York	2,593,096
Mitsui Manufacturers Bank	Mitsui Bank, Ltd.	California	1,817,647
Mitsubishi Bank of California	Mitsubishi Bank, Ltd.	California	1,490,517
Tokai Bank of California	Tokai Bank, Ltd.	California	1,470,711
Daiwa Bank Trust Co.	Daiwa Bank, Ltd.	New York	1,242,555
LTCB Trust Co.	Long-Term Credit Bank of Japan, Ltd.	New York	459,573
Dai-Ichi Kangyo Bank of California	Dai-Ichi Kangyo Bank, Ltd.	California	229,638
Mitsubishi Trust & Banking Corp. (U.S.A.)	Mitsubishi Trust	New York	144,373
Kyowa Bank of California	Kyowa Bank, Ltd.	California	93,099
Dai-Ichi Kangyo Trust Co.	Dai-Ichi Kangyo Bank, Ltd.	New York	0
Mitsui Finance Trust Co.	Mitsui Bank, Ltd.	New York	0
Tokai Trust Co.	Tokai Bank, Ltd.	New York	0
Mitsubishi Bank Trust Co. of New York	Mitsubishi Bank, Ltd.	New York	n.a.
Total			39,244,882

Source: Federal Reserve Board, unpublished data.

they had less confidence in the bank than they did in the issuer of the security; the bank in that instance brings little of value to the deal.

In recent years, as some U.S. banks have gotten into trouble, they have had a problem competing for this business. An extreme example was Continental Illinois Bank, which had a close brush with bankruptcy in 1984 and found its credibility in this business decline dramatically. The booming demand for letters of credit and a diminished ability by U.S. banks to provide them created a niche for Japanese banks, particularly with local governments. Generally highly regarded by credit rating agencies, Japanese banks' letters of credit were valuable. Their willingness to offer attractive terms won them business throughout the country. Sanwa Bank, for example, had commitments totaling $3.5 billion at the end of 1986.

Competitive Factors

If a Japanese-owned bank should beat out an American bank for the business of say, the city of Chicago (as it did in one well-publicized incident), the effect is not the same as if Chicago were to buy Toyota trucks. In the latter case, the Japanese firm would do most of its work in Japan; in banking the work would be done in the Chicago and New York offices of the Japanese bank. When Americans buy banking services from a Japanese-owned bank they are providing business for the American banking system to almost the same degree as if they bought the services from a purely domestic bank, and the trade balance is scarcely affected.

Still, some might argue that the ownership of the bank matters. What are the prospects that a larger part of the American banking system will be Japanese-owned? Some factors clearly favor the Japanese. Japanese banks have traditionally been permitted to operate with lower ratios of capital to assets. If this ratio is low, a bank can make a bigger return on equity for any given margin that it earns on assets. For example, if it borrows money at 8 percent and relends it at 10 percent, its margin is 2 percent against assets if it has no other expenses. The 2 percent margin implies a higher return on equity if the level of equity relative to assets is lower. Alternatively, it could shave the margin on its loans and earn the same return on equity as a bank with a higher capital-equity ratio.

This advantage is less than it appears, though. New international agreements are likely to force Japanese banks into conformity with the same rules as U.S. banks, with both countries toughening their requirements (see JEI Report No. 47B, December 18, 1987). During the expected five-year transition to the new rules, Japanese banks will have less of an advantage than they might: low capital ratios can be expected to make them stay away from some risky deals that banks with higher capital ratios would welcome. High capital ratios not only reduce rates of profit, they also act as a cushion against bad loans.

Another advantage is implicit in the previous discussion. Japanese firms are used to dealing with Japanese banks. As Japanese manufacturing firms come here in greater numbers, Japanese banks will benefit too. While this might seem parochial, American firms moving abroad after World War II preferred U.S. banks and provided an important impetus for the banks to follow.

Then, too, Japanese banks are likely to benefit from a current account surplus in Japan's favor and a strong currency, which suggests that they are likely to continue to have the liquidity and be of a size relative to U.S. banks that makes it much easier to take on large commitments. Despite the efforts of American banks and securities firms, Japanese financial institutions are likely to continue to get most of the business of recycling Japanese surplus savings to the United States and elsewhere.

Japan's home market for financial services is, by most measures, the biggest outside the United States. For this reason alone the banks are likely to feel more comfortable in the United States than those foreign financial institutions with smaller domestic markets. As nationwide banking expands here, Japanese banks, which can operate nationwide at home, may be well positioned to exploit new opportunities.

Many have argued that Japanese firms in general have superior management compared to U.S. firms. They cite as examples transplant Japanese motor vehicle companies employing American workers that seem to be better in almost every way than American automotive companies. If this is true for banks as well, then U.S. banks could have a challenge on their hands, first in California where Japanese banks are well established, but later all over the country.

How Are They Doing?

If success is gauged by market share, whether assets or deposits, then Japanese banks have been successful; they are growing relative to American banks. There are reasons to believe, however, that such a measure misses the point in an important way. Bank size reflects financial power, not expertise in banking necessarily. Japanese financial power is obviously at an all-time high, so the capital flows and asset levels for Japanese banks are too. But bigger does not necessarily mean better.

There are indications that Japanese banks are not doing banking better than U.S. banks, at least not on American turf. Because foreign bank agencies and branches are legally part of the home office, little profit data are available. But studies of subsidiaries of foreign banks generally show that they are no more profitable than other U.S. banks, although there is evidence that the banks were less profitable than average before the foreign bank acquired them. Foreign bank ownership may be a way to bring laggard banks up to the average, but the studies hardly point to an overall superior performance by foreign banks in this country. In a few cases Japanese banking companies have had difficulty running their U.S. acquisitions, as Fuji Bank's purchase of Walter E. Heller's two commercial finance units in 1984 illustrates. Los Angeles-based Manufacturers Bank, as one of the most profitable banks in the entire country, was very attractive to Mitsui Bank. In 1986, however, the subsidiary suffered big losses and Mitsui had to make important management and operating changes.

Will Japanese banks be able to buy market share and later earn big profits, repeating a pattern apparently observed elsewhere? Or will Japanese banks be content with market share, never earning the profits Americans expect but still dominating the market?

The answer to the first question is no. The "market share now, profits later" argumemt assumes entry barriers that would prevent any firm from moving in to reap the high profits Japanese banks would presumably want eventually. There are thousands of banks in the United States, including a handful of giant super-regional banks, as well as increasing competition from non-bank financial institutions like American Express Co., brokerage houses and insurance companies. Japanese banks are unlikely to drive out enough existing competition or prevent the development of new competitition.

As for the second query, Japanese banks will not be content with just developing and holding a large market share in the future, even if that was enough previously. The same factor that is driving them to the United States will work to make them more sensitive to profit concerns. As investors increasingly see the possibility of investing in markets anywhere, Japanese banks will compete with U.S. and European banks for the investor's favor. Increasingly, banks all over the world will be subject to the same investor criteria, and if it has been possible for Japanese banks to sacrifice profit for market share, it no longer will be.

The Future

The banking world continues to be in a state of flux. Deregulation is an ongoing process in both the United States and Japan, and the remaining regulations and supervisory practices are becoming more uniform. This suggests that in the future Japanese and American banks are likely to become more similar.

A major question on both sides of the Pacific is the separation between investment and commercial banking, currently mandated by Article 65 of the Securities and Exchange Law in Japan and the Glass-Steagall Act in the United States, which Congress is considering changing. While changes are being considered in both countries, Japanese and U.S. commercial banks are stretching existing restrictions on investment banking to the limit, sometimes using foreign locations in London and elsewhere to do some investment banking. The Industrial Bank of Japan, Ltd. has emerged as one of the world's leading underwriters of bonds in the Euromarket, even though it is very restricted in underwriting bonds in Japan and the United States. Sumitomo Bank Ltd.'s purchase of a stake in Goldman Sachs & Co., a leading American investment bank, also indicates an interest in this business, although Sumitomo has found its operational role very restricted. In one act Sumitomo managed to undermine the restrictions in both countries. On the one hand, as a bank operating in America, it bought part of an investment banker despite Glass-Steagall; on the other, it has an interest in a firm with a seat on the Tokyo Stock Exchange, thereby undermining Article 65. If existing laws remain intact, this kind of activity will increase.

There is a sense in both countries that Article 65 and Glass-Steagall will both eventually be significantly loosened or even repealed. When that happens, banks and securities companies will be able to invade each other's turf here and in Japan, as they do now in the Euromarket. Japanese banks have had limited success there, as Table 7 shows. Bond underwriting, an investment banking activity, is dominated by the investment banks, as expected. For the United States, commercial banks are represented on the list by Morgan Guaranty Trust Co. and Bankers Trust Co.; for Japan, by the Bank of Tokyo and the Industrial Bank of Japan. In 1986 Japanese banks had about 4 percent and U.S. banks about 9 percent of the Eurobond business.

Table 7: Leaders in the Eurobond Markets, 1986

(in millions of dollars)

	Total
Credit Suisse First Boston	$122,757
Union Bank of Switzerland	99,016
Morgan Stanley and Co.	96,893
Swiss Bank Corp.	95,197
Nomura Securities Co., Ltd.	94,298
Merrill Lynch & Co.	89,190
Morgan Guaranty Trust Co.	88,407
Banque Bruxelles Lambert	87,004
Deutsche Bank AG	83,978
Warburg Securities	82,781
Daiwa Securities Co., Ltd.	82,658
Banque Nationale de Paris SA	80,186
Salomon Brothers Inc.	79,830
Banque Paribas SA	72,170
Goldman, Sachs & Co.	67,920
Orion Royal Bank, Ltd.	62,906
Nikko Securities Co., Ltd.	62,305
Bank of Tokyo, Ltd.	59,581
Dresdner Bank AG	59,025
Industrial Bank of Japan, Ltd.	56,570
Credit Lyonnais	56,039
Bankers Trust Co.	54,006
County Natwest Ltd.	53,904
Yamaichi Securities Co., Ltd.	53,493
Commerzbank AG	53,493

Source: Industrial Bank of Japan

Regardless of the fate of Glass-Steagall or Article 65, Japanese banks are likely to be important in the future of American banking. As the biggest banks in the world, occupying 12 of the top 20 positions in terms of assets (although not in profits), they could figure prominently in any large-scale bailouts in the U.S. financial services industry. Even though merger activity has slowed in the past few years, with the dollar at record low levels relative to the yen, U.S. banks and other financial service firms are likely to look attractive to Japanese banks.

For further information contact Douglas Ostrom.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.